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C O N F I D E N T I A L SECTION 01 OF 05 BAKU 000411

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SUBJECT: ECONOMIC DECISION-MAKING AZERBAIJANI STYLE

REF: STATE 27788

Classified By: Ambassador Reno L. Harnish III per 1.4 (b,d).

11. (C) SUMMARY: President Ilham Aliyev is the lead economic and political decision-maker in Azerbaijan. Aliyev, however, makes most economic policy decisions relying upon a small close group of business contacts and trusted government ministers. High-level economic decision-making in Azerbaijan remains a mostly murky mystery with only whispers of rumors escaping from the inner circle. Based on past and current economic policy decisions, one can conclude that President Aliyev and his close allies generally make key economic decisions based on their personal business and financial interests. That said, President Aliyev and some in his government have also promoted several poverty reduction and regional economic development programs. Most government officials in Azerbaijan operate large, powerful personal businesses that deal directly with the government. This collusion between the GOAJ and private business controlled by the economic elite makes the task of unveiling economic decision-making difficult. END SUMMARY.

12. (C) Answers are keyed to reftel questions:

13. (C) A. With the changes in Aliyev's economic circle, which officials are most likely to have decision-making authority on key fiscal and energy issues?

14. (C) Fiscal decision-making in Azerbaijan is determined haphazardly and without much economic strategy or long-term planning. Within the GOAJ, Economic Development Minister Heydar Babayev, a close personal friend of President Aliyev, currently has the most sway over economic decision-making in the government. As a successful businessman and former banker in London, he has quite a bit to gain or lose based on GOAJ economic, fiscal and monetary decisions. Despite his personal interests, Babayev has declared to some interlocutors that he has already made his fortune and does not seek government office to make money.

15. (C) Babayev's family, like those of many government officials, operates a large holding company, ABU Holdings, that has many different subsidiaries, including Bank Standard and ABU gasoline stations. While not directly connected to the jailing of Former Economic Development Minister Farhad Aliyev, he and his family's company have benefited tremendously from the arrest and subsequent breakup of businesses connected to Aliyev, particularly AzPetrol. Babayev personally benefited with Farhad Aliyev's arrest by assuming his position as Minister of Economic Development. Babayev had previously been Chairman of the State Securities Committee. In addition, Babayev's family oil and banking businesses benefited with the breakup of the competitive AzPetrol business and the investigation of the Farhad Aliyev connected Bank of Baku.

16. (C) In addition, we believe that the current Minister of Emergency Situations, former Chairman of the State Customs Committee and another close contact of President Aliyev, Kemalladin Heydarov, exerts significant influence over economic decision-making, if only in an indirect way. While neither his former position, nor his current Ministry has any jurisdiction over economic, monetary or fiscal economic policy, he certainly can influence policy using his close ties to the President and his tremendous wealth.

17. (C) Heydarov was originally appointed by former President Heydar Aliyev to the Customs Committee to facilitate lucrative oil exports from Azerbaijan. While at Customs, he oversaw a large source of budget revenue for the GOAJ in tariff collections. He expanded Customs, income by systematizing bribery within the organization. Post has recently heard rumors that Customs 'fees' for imports under the new Customs Chairman Aydin Aliyev have increased six to 15 times in recent months. The "fee" increase is so high, that some importers are holding their goods at the border rather than bring them into the country.

18. (C) It remains to be seen what role Heydarov will play in his new Ministry of Emergency Situations. He has already begun to exert political power by gobbling up several minor agencies and his newly created super-ministry cuts across the

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areas of interest of several different ministries. It appears that Heydarov will now have his own armed troops ("militarized special guard service"), criminal investigation capacity, and ships and wharfs formerly run by the Caspian Specialized Emergency and Rescue. On a more interesting note, President Aliyev also transferred to MES the former State Agency for City Planning and Architecture, which means that the MES may control city-related construction and architecture issues. Observers have cynically noted this is a potential windfall for Heydarov that on the surface seems to have little link to emergency situations.

19. (C) The Ministry of Finance and National Bank of Azerbaijan wield limited influence over fiscal and monetary policy. Both Finance Minister Alakbarov and National Bank Chairman Rustamov are long-time political players but do not appear to have the personal connections or charisma that would add weight to their efforts to reform the economy and spur economic growth. They are both talented technocrats who are attempting to perform their duties while surrounded by disjointed and dangerous economic decision making.

10. (C) On energy, it appears that Valekh Alasgarov, formerly head of the Foreign Investment Department at SOCAR, will continue to have great influence over Azerbaijan's energy policy in his new incarnation as one of Parliament's deputy speakers and the chairman of Parliament's Energy Committee. He had been instrumental in the negotiations for the Baku-Tbilisi-Ceyhan pipeline and is now playing a leading role on the intergovernmental agreement with Kazakhstan, bluntly saying that the agreement will not pass Parliament in its current form. Embassy contacts have been told that he is taking his orders directly from the President.

11. (C) Another player in Azerbaijan's energy policymaking circle is current SOCAR President Rovnag Abdullayev, who is close to President Aliyev. Abdullayev is the former president of the Heydar Aliyev Oil Refinery, an institution closely connected to the leadership in Azerbaijan. He has brought many of his deputies from the oil refinery to SOCAR. Many of them are also politically connected to the government. Abdullayev supposedly has a family connection to someone in the presidential security apparatus. Several in the international energy community in Baku have expressed concern that SOCAR appears adrift under Abdullayev's leadership. Some of this may be due to the fact that Abdullayev seems focused on reorganizing SOCAR internally, but the end result is that he seems much less involved in setting national or international policy for the organization.

12. (C) The status of current Minister of Energy and Industry (MEI) and former SOCAR President Natik Aliyev is unclear. According to some reports, he was not happy about his reassignment to the MEI from SOCAR and appears to be on the outs in the government. Others have characterized his new position as a sinecure. However, in several meetings Aliyev has said that he intends to focus on the industrial part of his portfolio. This work will involve both expanding and restructuring the MEI itself (it currently is very small) and in getting a handle on the hundreds and hundreds of state enterprises and public/private enterprises in Azerbaijan. This will leave Aliyev little time to work on Azerbaijan's national/international energy policies at anything more than the broadest possible level. Aliyev has also disclaimed any interest in taking over international negotiating functions from SOCAR.

13. (C) Another figure in Azerbaijan's energy establishment worthy of note is Samir Sharifov, the head of the State Oil Fund of Azerbaijan. He appears to have carved out an important role where macroeconomics intersects with energy, especially when dealing with Western interlocutors. AIOC President David Woodward has said that he believes Sharifov is President Aliyev's primary strategic-level advisor on

energy issues. A second figure of note is former diplomat Elshad Nazirov, SOCAR's vice president for marketing and development. He represented SOCAR at the recent conference called by Deputy Foreign Minister Araz Azimov to highlight how Caspian energy resources can meet the demands of European markets and deals a lot with the international community. Both men are fluent English speakers and very comfortable in the international arena.

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¶14. (C) B. To what degree does Aliyev maintain final authority on economic decision-making and how much does he depend on expert advice?

¶15. (C) By all accounts, President Aliyev follows closely the macroeconomic situation and retains final economic decision-making power. While President Aliyev most certainly makes some economic decisions based upon his personal and family wealth interests, he has led GOAJ efforts to reduce poverty and increase the economic development of Azerbaijan's regions. He is widely rumored to be Azerbaijan's richest person and his wife Mehriban Aliyeva is from the politically powerful Pashayev family. While it is widely assumed that Aliyev controls vast assets, Aliyev is not linked either publicly or privately to any known business ventures in Azerbaijan. Most Azerbaijanis believe that President Aliyev transferred all of his personal assets into his wife's name upon taking office in 2003; she also is not linked either publicly or privately to any known businesses in Azerbaijan.

¶16. (C) It is unclear if President Aliyev relies on expert advice. President Aliyev once grumbled to the Ambassador that he cannot rely on his ministers to provide him with sound technical advice and often has to read up on key policy decisions on his own. The advice that Aliyev receives from his ministers and advisors would tend to be slanted towards their own personal business and financial interests. The President would certainly filter any advice he receives through his own complex personal business and financial interests in order to make final economic policy decisions.

¶17. (C) Minister Babayev is rumored to have been the man in charge of the First Family's money, which may make Ilham's filter a little less dark when dealing with Babayev, who probably has many of the same types of interests. Another influential figure, the President's Chief of Staff, Ramiz Mehdiyev, maintains significant business interests in Russia, is rumored to have connections to Lukoil and holds extensive property in Baku. There are no known high-level foreign advisors to the President, although most certainly his international bankers could, if requested, provide some economic and financial advice.

¶18. (C) At a recent brainstorming meeting with the Ambassador, Babayev removed Presidential Economic Advisors Vahid Akhundov and Ali Asadov from a proposed guest list for a macroeconomic and budget workshop. Babayev remarked that he had not seen Akhundov in months and that "the President does not listen to Asadov." In theory, both Akhundov and Asadov are supposed to be close economic advisors to the President. It was clear from Babayev that he did not consider them to be relevant. In addition, Post has been trying since early January to arrange a meeting with Akhundov but has been repeatedly told he is on "vacation."

¶19. (C) Some of Azerbaijan's economic decisions appear to be modeled after Russian President Putin's decision-making style, teetering on the brink of an oligarchy. Reminiscent to the Yukos affair in Russia, Azerbaijan recently pulled apart AzPetrol, a company connected to the jailed brother of former Minister of Economic Development Farhad Aliyev, and gave different parts of the company to insiders, including Jalal Aliyev, brother of late President Heydar Aliyev and uncle of Ilham. The principal owners of AzPetrol, Rafik Aliyev, and his brother, former Minister of Economic Development Farhad Aliyev, remain jailed on charges of plotting a coup in November 2005. All the businesses in Azerbaijan with any connection to the Aliyev brothers have been inspected by government authorities and in some cases owners have been jailed on suspicion of collusion with the Aliyev brothers.

¶20. (C) The recent AzPetrol case highlights that the GOAJ believed that Farhad Aliyev had gone too far politically and had too much influence economically. The government's final decision to remove Farhad Aliyev most likely was based on a political fear that he, along with others inside and outside of Azerbaijan, were planning a coup. As a result of Aliyev's removal and his brother Rafik Aliyev's detention, business rivals in the GOAJ, including Babayev, seized upon the opportunity to break up the successful and competitive AzPetrol gasoline stations business model. The fact that the

President decided to remove him from office only weeks before a highly anticipated Parliamentary election could indicate the willingness of the President and his close associates to risk international condemnation for political and economic gain. Economic interests aside, however, President Aliyev seems to genuinely believe that Farhad Aliyev posed a real security risk.

¶21. (C) C. Which officials in the economic sphere are most resistant to advice from the international financial institutions? Can post speculate on the reasons behind this resistance?

¶22. (C) To one extent or another, all of Azerbaijan's key decision makers are resistant to advice from the international financial institutions (IFI). Economic Development Minister Heydar Babayev is the most resistant to the International Monetary Fund and its past efforts to reform the economy, and especially its attempts to privatize the state-owned International Bank of Azerbaijan. Babayev also has criticized the role of the European Bank of Reconstruction and Development for its investments in mid-tier banks, such as Bank of Baku and UniBank.

¶23. (C) In several meetings with Ambassador Harnish, Babayev has gone out of his way to criticize the IMF and the EBRD. In the latest meeting to review the agenda for an upcoming macroeconomic and budgetary workshop, Babayev requested that the IMF resident representative not give a presentation. Instead, Babayev said that a World Bank representative should make the presentation, noting that the World Bank "gives us money and is trying to help us."

¶24. (C) Babayev's dislike for the IMF may be connected to his personal business and financial sector interests. His family controls or is shareholder in many different businesses in Azerbaijan. Babayev's family operates ABU Holdings, which has interests in banks (Bank Standard), gasoline stations and other businesses. The IMF's financial and economic prescriptions would adversely affect ABU's preferential position and its many businesses.

¶25. (C) Babayev's dislike for EBRD seems to come from his personal business dealings in Russia. He has told the Ambassador that the EBRD invested heavily in banks in Russia during the 1990s, similar to its current efforts in Azerbaijan. This investment, according to Babayev, led the banks to bankruptcy. EBRD's private equity investments in certain banks in Azerbaijan also threaten the competitiveness of Babayev's family bank, Bank Standard. Babayev also appears to have a personal dislike for the Canadian head of the EBRD.

¶26. (C) Any resistance to IFI policies by other key economic actors would be due to their personal business and financial interests. Presidential Chief of Staff Ramiz Mehdiyev maintains extensive business interests and looks more towards Russia for economic advice than the West and the IFIs. Minister of Emergency Situations and former Chairman of the Customs Committee, Kemalladin Heydarov, is one of the principal shareholders in ATA Holdings, along with the current Minister of Taxation Fazil Mammadov. Mammadov was the deputy to Heydarov at Customs in the 1990s. ATA Holdings, which comprises firms in banking, insurance and financial services, construction, and industry, would stand to profit or lose based on IFI reform directives and policies.

¶27. (C) D. What relationships do key energy decision makers maintain with energy officials in Russia and Turkey? Do they share business ties?

¶28. (C) In general, there is a great deal of business and trade between Russia and Azerbaijan. Banking contacts have told Embassy officers that as much as USD 3 billion per year flows between the two countries, while GOAJ officials put the figure only at USD 1 billion. Two-thirds of this amount never enters the banking system and operates in a "gray market" of business deals negotiated between contacts in Baku and Moscow. While we do not have specific figures, it is safe to assume that a significant portion of this trade is due to personal connections between Azerbaijani government officials and Russian businesses. Azerbaijan also trades

other areas of Azerbaijan.

¶29. (C) Presidential Chief of Staff Ramiz Mehdiyev, in particular, maintains significant business interests and wields enormous political power. Mehdiyev has deep commercial ties to Russia, including rumored political and Lukoil connections. With construction booming in Baku, Mehdiyev also controls elements of the lucrative trade in construction materials, including high quality Russian steel rebar. Mehdiyev may be involved with the GOAJ's efforts to force out Turkish electric company Barmek from Azerbaijan and replace it with Russian electric company UES.

¶30. (C) Post has little information on ties among energy decision makers in the region. It is certainly probable that many energy decision-makers have ties to Russia, or Turkey, or both, given historical experience. However, any such relationships are probably personality-based. The Turkish electrical-distribution company Barmek has had great difficulties in Azerbaijan and is facing a possible shutdown in Azerbaijan. The energy sector appears to be one area where Russian influence has not penetrated. Russian interests tend to aim more at blocking or blunting Azerbaijan's initiatives, for example by trying to sew up the gas market in southern Europe to prevent a greater role for Azerbaijani gas in Europe. Russian officials (unlike Turkish officials) are not invited to or do not attend international energy meetings in Baku. This is in contrast to the privileged position that Russian companies have acquired in the non-energy sector, in areas ranging from the construction industry to shipping registries.

¶31. (C) Post notes, however, that while there may be a number of commercial energy deals (Azerbaijan buys some gas from Gazprom), Russian and Turkish firms do not appear to own or control any pipelines and have only minor offshore gas and oil interests compared to other Caucasus countries.

HARNISH